

**Letter of Findings: 01-20171299
Individual Income Tax
For the Years 2014 and 2015**

NOTICE: IC § 6-8.1-3-3.5 and IC § 4-22-7-7 require the publication of this document in the Indiana Register. This document provides the general public with information about the Department's official position concerning a specific set of facts and issues. This document is effective on its date of publication and remains in effect until the date it is superseded or deleted by the publication of another document in the Indiana Register. The "Holding" section of this document is provided for the convenience of the reader and is not part of the analysis contained in this Letter of Findings.

HOLDING

Sole Shareholder of an S Corporation operating a combination gas station / convenience store, was unable to meet his burden of establishing that the Department's proposed assessment of additional income tax was wrong; Shareholder failed to maintain complete, contemporaneous, and accurate records of fuel and convenience store item sales, and Shareholder's unsubstantiated reconstruction of its business records did not overcome the deference properly afforded the Department's original assessment.

ISSUE

I. Indiana Individual Income Tax - Flow-Through Business Income.

Authority: IC § 6-3-4-11; IC § 6-3-4-11(a); IC § 6-8.1-5-1(b); IC § 6-8.1-5-1(c); IC § 6-8.1-5-4(a); *Dept. of State Revenue v. Caterpillar, Inc.*, 15 N.E.3d 579 (Ind. 2014); *Indiana Dep't of State Revenue v. Rent-A-Center East, Inc.*, 963 N.E.2d 463 (Ind. 2012); *Lafayette Square Amoco, Inc. v. Indiana Dep't of State Revenue*, 867 N.E.2d 289 (Ind. Tax Ct. 2007); [45 IAC 15-5-1](#).

Taxpayer argues that the Department of Revenue overstated the amount of income attributable to his ownership interest in a gas station / convenience store business location.

STATEMENT OF FACTS

Taxpayer is an Indiana resident who files individual Indiana joint income tax returns along with his wife although, at the time of the 2014 and 2015 audit, Taxpayer had not filed a 2014 Indiana tax return. Taxpayer is the sole shareholder of an S Corporation. The S Corporation operates as a retail business which sells fuel and convenience store items. The store sells soda, candy, chips, cigarettes, prepaid phone cards, lottery tickets, and the like.

The Indiana Department of Revenue ("Department") conducted a sales, use, withholding, and food and beverage tax audit of the business location. That audit resulted in an assessment of additional tax based on the audit's determination that the business earned previously unreported additional income. The additional income eventually "flowed-through" to Taxpayer as the S corporation's sole shareholder.

As a result, the Department issued Taxpayer an assessment of additional individual income tax. Taxpayer disagreed with the assessment of income tax and submitted a protest to that effect. An administrative hearing was conducted during which Taxpayer's representatives explained the basis for the protest. This Letter of Findings addresses the assessment of individual income tax.

I. Indiana Individual Income Tax - Flow-Through Business Income.

DISCUSSION

The issue is whether Taxpayer established that the assessment of Indiana income taxes was entirely unwarranted on the ground that the Department's audit overstated the amount of convenience store and fuel sales.

A. Audit Results.

According to the Department's audit report, Taxpayer was "contacted multiple times to obtain records." The Department's efforts to contact Taxpayer began February 2017 and concluded August 2017. As explained in the audit report:

- An "initial letter" was sent to Taxpayer's business address February 2017. Taxpayer did not respond to this first letter;
- A "certified letter" was sent to Taxpayer's business address March 2017. Although the signature card - indicating that the letter was received - was returned to the Department, Taxpayer did not respond to this letter;
- A letter requesting business documents was sent to the Taxpayer's business address April 2017. That letter requested that Taxpayer contact the Department's audit representative;
- The Department's audit representative "hand delivered a sealed records request" to Taxpayer's business location June 2017;
- Taxpayer called the Department's representative stating that "he had not received prior notifications from the auditor." As detailed in the subsequent audit report:
 - The auditor explained the audit and what records would be required to complete the audit. Auditor obtained a contact number and email address from the [T]axpayer. Auditor emailed a list of required records and a projected best information available adjustment for sales and use tax if records are not provided. A deadline of June 14, 2017 was given to provide records for audit.
- On June 12, 2017, Taxpayer emailed the Department's representative requesting an additional 60 days to provide the requested records. The Department's representative granted the request extending the deadline to provide the requested records to August 2017.
- On August 1, the Department's audit representative emailed Taxpayer reminding him of the deadline to provide the necessary records.
- On August 3, Taxpayer asked for a 30 day extension to provide the records. Four days later the Department's audit representative denied the request and proceeded to issue assessments based on the "best information available."

The audit of Taxpayer's business resulted in assessments of additional withholding tax, Delaware County food and beverage tax, and gross retail (sales) tax the details of which are set out in a related Letter of Findings docketed as 04-20171296; 10-20171297; 03-20171298.

During the course of the administrative protest, Taxpayer's representatives explained that the originally requested records were unavailable because they had been inadvertently destroyed.

B. Taxpayer's Response.

Taxpayer's representatives object to the assessment of sales, withholding, and food and beverage tax on the ground that the audit's assessments of tax was excessive because the Department's audit overstated the amount of sales attributable to Taxpayer's fuel and convenience store.

Although Taxpayer failed to provide the Department's audit with underlying sales and business transactions, Taxpayer's representatives have reconstructed what the representatives believe is a more accurate method of determining the convenience store's sales activities. Taxpayer's representatives explain that they are unable to produce the records originally requested February through August 2017 because - although those records were destroyed - their substitute calculation is more accurate than the Department's own assessment.

Taxpayer's representatives explain that they reviewed the S Corporation's bank account deposit records for 2015 through 2016. After reviewing the deposit records, Taxpayer deducted - as unrelated income - transfer deposits received from Taxpayer's unrelated business interests. Taxpayer also deducted "refunds and rebates" attributable to the S Corporation's fuel supplier. Taxpayer then deducted the amount of sales and food and beverage tax amounts paid on behalf of the S Corporation. Taxpayer's representatives conclude that Taxpayer had no unreported income and that the Department's pending assessment of additional income tax is entirely

C. Hearing Analysis.

As a threshold issue, it is the Taxpayer's responsibility to establish that the existing tax assessment is incorrect. As stated in IC § 6-8.1-5-1(c), "The notice of proposed assessment is prima facie evidence that the department's claim for the unpaid tax is valid. The burden of proving that the proposed assessment is wrong rests with the person against whom the proposed assessment is made." *Indiana Dep't of State Revenue v. Rent-A-Center East, Inc.*, 963 N.E.2d 463, 466 (Ind. 2012); *Lafayette Square Amoco, Inc. v. Indiana Dep't of State Revenue*, 867 N.E.2d 289, 292 (Ind. Tax Ct. 2007). Consequently, a taxpayer is required to provide documentation explaining and supporting his or her challenge that the Department's position is wrong. Further, "[W]hen [courts] examine a statute that an agency is 'charged with enforcing . . . [courts] defer to the agency's reasonable interpretation of [the] statute even over an equally reasonable interpretation by another party.'" *Dept. of State Revenue v. Caterpillar, Inc.*, 15 N.E.3d 579, 583 (Ind. 2014). Thus, interpretations of Indiana tax law contained within this decision, as well as the preceding audit, are entitled to deference.

As an individual conducting retail transactions and collecting sales and other taxes on behalf of the state, Taxpayer was required to maintain complete, contemporaneous, and accurate financial records including cash register receipts. "Every person subject to a listed tax must keep books and records so that the [D]epartment can determine the amount, if any, of the person's liability for that tax by reviewing those books and records." IC § 6-8.1-5-4(a). The "records" referenced "include all source documents necessary to determine the tax, including invoices, register tapes, receipts, and canceled checks." *Id.*

In the absence of accurate or complete records, Indiana law requires that the Department issue a proposed assessment based on the best information the Department can obtain. "If the [D]epartment reasonably believes that a person has not reported the proper amount of tax due, the [D]epartment shall make a proposed assessment of the amount of the unpaid tax on the basis of the best information available to the [D]epartment." IC § 6-8.1-5-1(b). See also [45 IAC 15-5-1](#).

Because Taxpayer operated his convenience store as an S Corporation, IC § 6-3-4-11 imposes on Taxpayer the responsibility of paying Individual income tax on his share of the income earned from that store. The statute provides in part:

A partnership as such shall not be subject to the adjusted gross income tax imposed by [IC 6-3-1](#) through [IC 6-3-7](#). *Persons or corporations carrying on business as partners shall be liable for the adjusted gross income tax only in their separate or individual capacities.* In determining each partner's adjusted gross income, such partner shall take into account his or its distributive share of the adjustments provided for in [IC 6-3-1-3.5](#).

IC § 6-3-4-11(a) (*Emphasis added*).

The Department is unable to agree that Taxpayer has made a quantifiably specific objection to the results of the audit sufficient to overcome the presumption of correctness afforded the original audit assessment. *Caterpillar, Inc.*, 15 N.E.3d at 583 (Ind. 2014). As detailed in a related Letter of Findings docketed as 04-20171296; 10-20171297; 03-20171298 addressing the S Corporation's substantive protest of the sales, withholding, and food and beverage tax, Taxpayer's calculation leaves a number of unanswered questions; is the bank account the sole account managed by Taxpayer? Does Taxpayer's calculation account for any cash only transactions between the S Corporation and its vendors? Does Taxpayer's calculation accurately account for the distinction between exempt and taxable customer transactions?

While Taxpayer's alternative calculation is not frivolous, it is no substitute for the contemporaneous, detailed records required under Indiana law.

The Department does not disagree with Taxpayer's suggestion that there *may* be an alternative method of determining the convenience store sales transactions, but Taxpayer has not met his burden of establishing that the assessment was "wrong" as required by IC § 6-8.1-5-1(c) and that the Department should not now defer to the original assessment.

FINDING

Taxpayer's protest is respectfully denied.

April 9, 2018

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An [html](#) version of this document.